

**Liquor Control Board
Wine and Beer
Three-Tier System Review**

FINAL DRAFT

SUBJECT TO CHANGE

**September 28
Meeting #6**



Welcome!



- Introductions

Agenda



	Topic	Purpose	Time	Outcome	Lead by
1.	Welcome / Introductions / Agenda / Previous meeting minutes	Information	10 minutes (10:00-10:10)	Information	Nate Ford (Task Force Chair)
2.	<i>Summary:</i> previous meeting decisions	Review	10 minutes (10:10-10:20)	Information	Sterling Associates
3.	<i>Briefing:</i> Update on the Costco Lawsuit Stay	Information	10 minutes (10:20-10:30)	Information	Rick Garza
4.	<i>Review and discuss:</i> Preamble language regarding economic impact of changes to the distribution and sale of beer and wine	Decision	10 minutes (10:30-10:40)	Decision on preamble language	Tim Hightower
5.	<i>Discussion:</i> TIED HOUSE: Ownership Interests	Decision	80 minutes (10:40-12:00)	Feedback and guidance	Sterling Associates
	Lunch		12:00 – 1:00		
6.	<i>Discussion:</i> TIED HOUSE: Money's Worth	Decision	60 minutes (1:00-2:00)	Feedback and guidance	Sterling Associates
7.	<i>Discussion of remaining work</i>	Information	15 minutes (2:00 – 2:15)	Information	Sterling Associates
8.	<i>Overview of next meeting, Wrap up-adjourn</i>		15 minutes (2:15 – 2:30)	Information	Sterling Associates

Previous Meeting



- **Motion to add preamble to policy goals still tabled** (*pending revisions from proposed language*)
- **Discussed the LCB regulations related to “compelling” use of distributors, impact measures for assessing 2SSB 6823, and impact measures generally.**
 - No recommendations were made.

Since September 14 meeting



- Issue paper prepared and distributed for review related to Tied House regulations.
- Stakeholder comments received and forwarded.
- Meeting notes from September 14 meeting distributed.

Objective of Today's Meeting



- Discuss and determine Task Force recommendations, if any, regarding the state's Tied House statutes.

Tabled Motion regarding Economic Impacts



- **Proposed Re-Draft Language for Preamble from Tim Hightower:**

Prioritization Results



Control and enforcement.						
7b	LCB in Competition	9	10	4	0	5.75
6d	Lack of Enforcement Resources	18	2	2	-3	4.75
6f	Lack of Impact Measures	18	2	1	-6	3.75
6a	Criteria for regulations	9	8	3	-6	3.5
7a	Rules for LCB retailing	3	8	4	-3	3
6c	Priority of Enforcement Resources	9	4	2	-6	2.25
6g	Complexity of rules	3	2	4	-6	0.75
6e	Paperwork	0	6	4	-9	0.25
Sales and distribution						
4b	Price Posting	24	0	2	-9	4.25
4c	Mandatory Mark-up	9	10	1	-6	3.5
4d	Quantity Discounts	15	8	0	-15	2
5f	Central Warehousing	3	12	2	-9	2
5g	Product Placement	9	2	3	-15	-0.25
4e	Delivered Pricing Total	0	4	5	-12	-0.75
5c	Foreign Imports	0	4	1	-9	-1
4f	COD	6	4	3	-18	-1.25
4a	Uniform Pricing	9	4	1	-21	-1.75
3c	Return of damaged	0	4	2	-15	-2.25
Relationship among tiers						
5a	Mandatory Use of Distributors	18	6	2	-12	3.5
3a	Money's Worth	12	6	3	-12	2.25
3b	Ownership	9	4	2	-12	0.75
5e	Sampling	9	0	3	-18	-1.5
5d	Retail-Retail	6	2	1	-15	-1.5
2	Anti-Competition	6	6	1	-21	-2
1	Advertising	0	10	2	-21	-2.25

Today we
will discuss
tied house
issues....

Relationship Among Tiers: Tied House



- “Tied House” refer to statutes and rules adopted by virtually every state, and at the federal level, to regulate how alcoholic beverages are marketed and how the various tiers of the industry interact.
 - Designed to prevent inappropriate or coercive business practices among the various sectors of the liquor industry, either through
 - domination of one tier over another or
 - through exclusion of competitors’ products.
 - Concern is that domination and / or exclusion would ultimately lead to abusive consumption and other social ills (underage drinking, etc.)
- **The overarching policy question for today:**
 - What is the state’s continuing role in preventing domination among tiers and / or exclusion of product?

Relationship Among Tiers: Tied House



- Washington's cornerstone Tied House Statute, RCW 66.28.010(1)(a) addresses the two fundamental aspects of tied house laws:
 - The prohibition against manufacturers, importers, distributors and authorized representatives from owning or having a financial interest in a retail license or owning property on which a retailer operates; and
 - The prohibition against manufacturers, importers, distributors, and authorized representatives from providing things of value ("money or money's worth") to licensees.

Relationship Among Tiers: Tied House



- **Washington's Tied House Statute was adopted in the 1930s.**
- **Since then, the business and consumer environment has changed dramatically. For example:**
 - Highly complex, diversified ownership arrangements have developed that were never contemplated in the 1930s.
 - Business transactions occur in a globalized marketplace.
 - Retail outlets have become significantly more diverse.
 - Manufacturers have multiplied into a diverse array of mostly small wineries and breweries, creating a highly competitive market and increased volume and choice of product.
 - Consumers are more sophisticated, demanding and accustomed to diverse selection;
 - The power of the supplier tier has been matched by the power of mega-retailers.

Relationship Among Tiers: Tied House



- Washington's approach to these changes has been to carve out discrete, targeted legislative exceptions as the need arises.
- Many points of view on this approach. For example:
 - Some like the incremental approach...sound, conservative way to accommodate without compromising the foundation.
 - Some do not like it...over time, seriously eroded the foundation making application impossibly convoluted and nearly unenforceable.
 - Enforcement staff find the patchwork of exceptions difficult to explain and enforce.
 - Health and safety advocates fear that further loosening of the Tied House statutes may have significant, negative consequences.
 - And policymakers question whether it may be time for a more comprehensive set of revisions.

Relationship Among Tiers: Tied House



- **Federal Alcohol Administration Act (FAA):**

- The FAA Tied House regulations allow total ownership of a retailer, and allow partial ownership of a retailer provided there is no significant impact on competition.
- The FAA prohibits a number of activities that are also prohibited under Washington law (providing things of value to a retailer, paying for retailer advertising, for example) but **ONLY IF** the activity results in exclusion.
- Exclusion means that a practice:
 - **places a retailer's independence at risk** by means of a tie or link between the supplier and the retailer; AND,
 - that such practice results in the **retailer purchasing less than it would have of a competitor's product.**
- These exclusion requirements make it difficult to prove a violation.

Relationship Among Tiers: Tied House



- **Other states:**

- All states responding to the survey have tied house laws in place prohibiting overlapping financial interests and providing items of value.
 - Some are more stringent than others
 - Some have provided general *de minimis* exceptions (allowing small or minimal variances without explicit authority)
 - Others have taken WA's approach and provided specific, narrowly drawn exceptions (some a few, others many)
- California: General prohibitions in place, with numerous narrow exceptions.
- Oregon:
- Texas:

TIED HOUSE: OWNERSHIP AND FINANCIAL INTEREST



OWNERSHIP AND FINANCIAL INTEREST

- **Washington's Tied House statute prohibits suppliers (manufacturers, importers, distributors) from:**
 - holding a financial interest in a retail licensee,
 - owning property on which a retailer is located; and
 - owning a retail license outright.
 - *Several exceptions to this general prohibition have been granted.*
- **The purpose of this prohibition has been to prevent the kind of practices that prompted Prohibition.**

TIED HOUSE: OWNERSHIP AND FINANCIAL INTEREST



OWNERSHIP AND FINANCIAL INTEREST

- The business environment has changed dramatically and new forms of ownership and financial networks have emerged that were not contemplated in the 1930s.
 - As a result, certain business arrangements are prohibited today even in circumstances where the opportunity for domination or control over the retailer is considered to be remote or controllable through other means.
 - Bass Public Limited Company (PLC) (exception has been granted)
 - Insurance company board member example from interviews

TIED HOUSE: OWNERSHIP AND FINANCIAL INTEREST



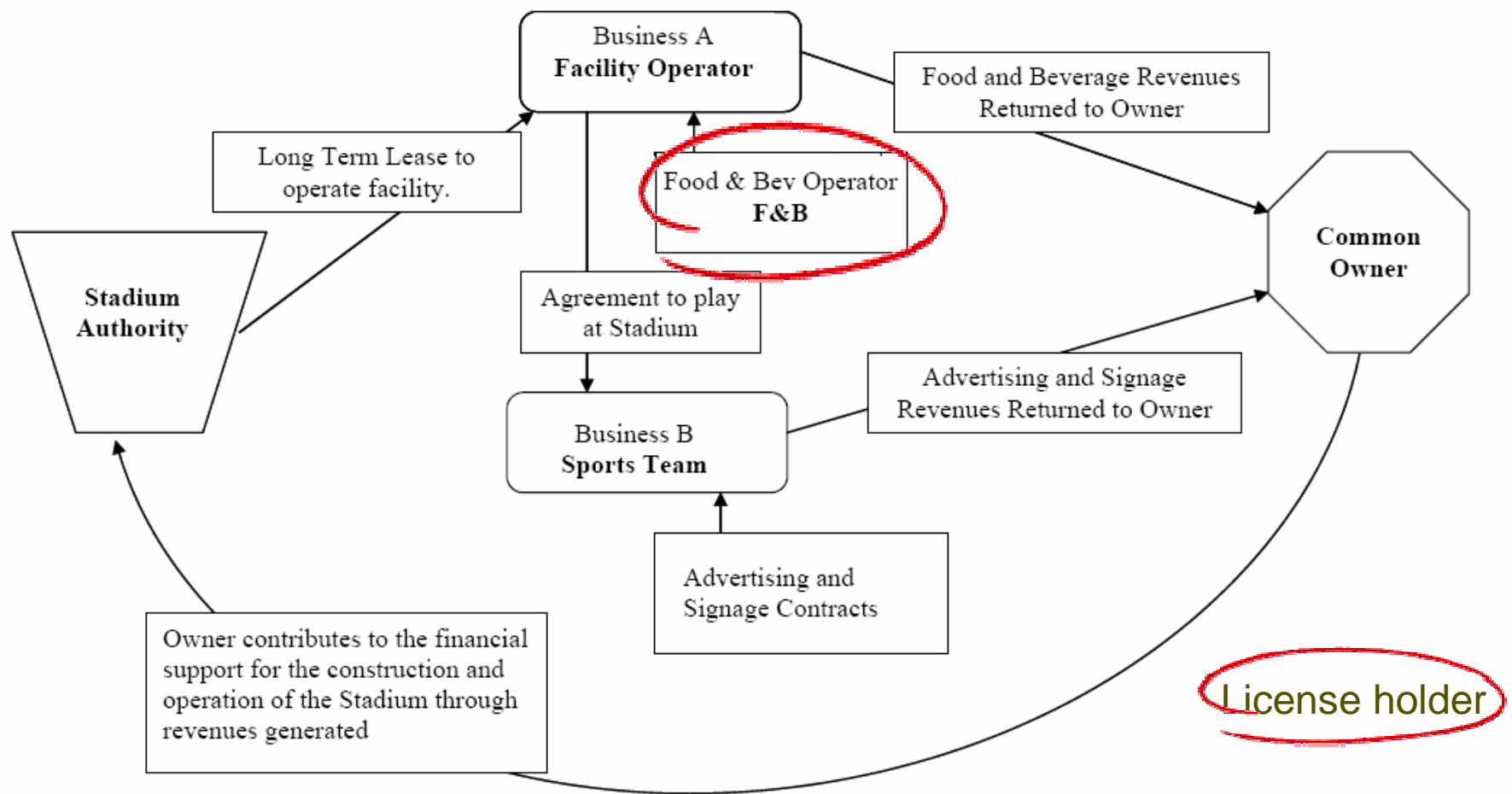
OWNERSHIP AND FINANCIAL INTEREST

- In 1999, the LCB convened a review panel to consider changes to the three-tier system, including Tied House statute's prohibition against overlapping financial interests among the tiers. The panel considered two alternative approaches.
 - Alternative # 1: Permit “*de minimis*” overlapping ownership interest, in which the arrangement would be permitted with certain safeguards in place
 - Alternative #2: Allow a certain numerical criteria for overlapping ownership – for example, up to 5% of stock ownership could be allowed, or no more than 10% of the product sold by the retailer in question could be from the interested manufacturer.
 - *A summary of other state tied house laws examined by the review panel is provided as a separate handout.*

TIED HOUSE: OWNERSHIP AND FINANCIAL INTEREST



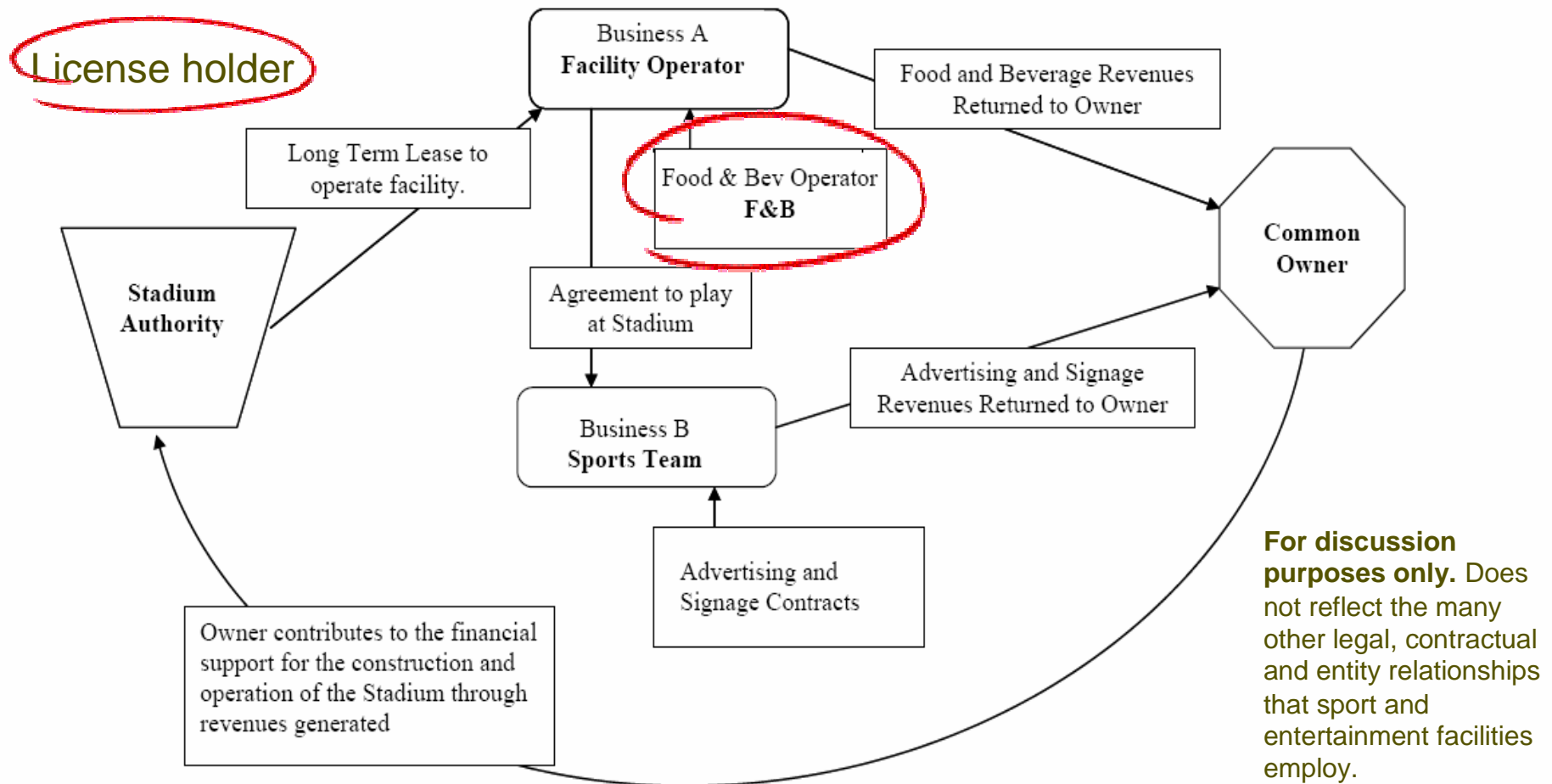
Scenario: Sports and Entertainment Facilities



TIED HOUSE: OWNERSHIP AND FINANCIAL INTEREST



Scenario: Sports and Entertainment Facilities



TIED HOUSE: OWNERSHIP AND FINANCIAL INTEREST



Scenario: Sports and Entertainment Facilities

- To increase revenues, Sports Team wants to enter into an agreement with a national beer manufacturer to name a club on the Stadium premises.
- Under the agreement, the club would be called the Geoduck Club, and the club would have a Geoduck theme – servers would wear Geoduck T-shirts, coasters would be stamped with their logo.
- Service within the club would continue to be provided by F&B, and F&B will continue to have complete discretion over what is poured in the Club.
 - In no case will the Geoduck be exclusively sold at the club (which would be a violation of the Federal Tied House rules.)

TIED HOUSE: OWNERSHIP AND FINANCIAL INTEREST



DENIED BECAUSE OF TIED HOUSE STATUTES AND RULES:

- Tied House laws prohibit the agreement. Operator is a “party in interest” in F&B’s sports and entertainment liquor license and Operator returns their profits from the F&B contract to Common Owner. Operator and Sports Team are both owned by Common Owner. Therefore, Common Owner (and by extension their subsidiary company Sports Team) has a financial interest in the retail liquor license.
- The Tied House law prohibits a retail licensee from entering into these types of advertising agreements, because such agreements may create undue pressure to serve primarily or exclusively the product of the naming entity (in this case Geoduck).

Lunch



TIED HOUSE: MONEY AND MONEY'S WORTH



MONEY AND MONEY'S WORTH

- The prohibition against manufacturers, importers, distributors and authorized representatives from providing things of value (“money or money’s worth”) to licensees.
 - Suppliers and retailers have difficulty understanding where the line is drawn between allowed and prohibited activities, and as important, why the line is drawn where it is.

TIED HOUSE: MONEY AND MONEY'S WORTH



MONEY AND MONEY'S WORTH

- **The purpose of these rules is to ensure that suppliers cannot control, through economic inducement, the actions of the retailer.**
 - It is difficult for industry participants to understand how accepting matchbooks or coasters from a supplier can reasonably be expected to translate into that type of control.
 - From an enforcement standpoint, the coasters represent a slippery slope. While one box may not represent an inducement, one hundred thousand could.
 - With the exceptions that have been granted, the once bright line between accepted and prohibited practices has become somewhat blurred.

TIED HOUSE: MONEY AND MONEY'S WORTH



- **Manufacturer wants to be able to give product away for sampling, as part of their marketing strategy. If a Specialty Wine Shop purchases three cases, the manufacturer may want to give them a case for free for wine tastings or to give to customers as samples.**
- **Manufacturers want to enter into agreements with retailers to provide sponsorships, rebates, or contests at the retail establishment.**
 - Restaurant A wants to have a basketball hoop shoot contest and offer a \$10,000 prize to bring customers in. Instead of having \$10,000 cash on hand in case someone wins, a third-party agent may be willing to take a \$1,000 bond and take the risk that the shooter will actually make the shot. A manufacturer supplying beer to Restaurant A may want to pay the \$1,000 to the third party assuming that does not violate the Tied House rules. However, it provides value to the retailer since the retailer would no longer have to put up the \$1,000 itself. Therefore it is a violation.
- **Advertising wine tastings at restaurants. A winery may want to advertise if a local retailer is featuring the winery's product at a wine dinner. This provides free advertising for the retailer and would be prohibited.**

TIED HOUSE: MONEY AND MONEY'S WORTH



SCENARIO -- Washington's Wine Industry:

- The in-state wine producers' marketing strategy is “educate and inform, experience and purchase.” Their emphasis is on finding ways to access the consumer to give him or her an opportunity to learn about the products, and taste them. Once exposed to the wines, consumers will purchase them.
 - Wine producers are concerned the Tied House laws limit their activities in a number of ways that constrain the industry's ability to market their product to consumers
 - They find it difficult to draw a correlation between the activity that is prohibited by the Tied House law and abusive consumption.
- The LCB sees each potential exception as an erosion of the state's ability to hold the line against domination and inducement.
 - Although some of the activities that are prohibited may seem innocuous the underlying rationale for the prohibitions have broader application and allowing these seemingly minor exceptions would start the state down a slippery slope. (On the other hand, some activities involve millions of dollars.)

MONEY AND MONEY'S WORTH - Examples



- **A winery's website can list the retailers at which the wine is sold, but cannot provide a link to those retailers.**
 - According to Tied House regulations, such a link provides value to the retailer and therefore is a violation of the money's worth provision.
- **A local restaurant wants to host a “wine dinner” in which the chef prepares dinner for guests, and pairs each course with a local producer's wine. The restaurant asks the wine maker to attend, talk about her wine, but the vintner cannot pour the wine. (Or, in the reverse, a winery wants to host a wine dinner featuring a prominent chef from a regional restaurant.)**
 - The basic Tied House rule: a manufacturer cannot provide a thing of value to a retailer because it could result in an inducement to sell that manufacturer's product and exclude a competitor.
 - A specific narrow exception to this general rule was carved out to allow wineries to educate consumers about the industry and their products. That specific exception did not extend to pouring (which could free up the retailer's staff to do other productive activities, thus providing “value” to the retailer.) Without an exception, the general prohibition applies.

MONEY AND MONEY'S WORTH - Examples



- A winery may hold a license to operate a restaurant on or contiguous with winery property, but may not operate a restaurant on their off-site retail premises. (So, for example, Chateau Ste. Fred could not open a restaurant, separate from its winery, where only Ste. Fred wines are served.)
 - This is a violation of the Tied House prohibition against manufacturers owning a retail license.
 - Exceptions to this prohibition have been provided to
 - in-state wineries and breweries to hold certain retail licenses on their own premises, and
 - in-state wineries to operate up to two off-site tasting rooms/off-premise retail outlets.
 - These exceptions have not been extended to allow the operation of a restaurant that serves only their own product off site.

MONEY AND MONEY'S WORTH - Examples



- **Most local wine makers are members of an industry association. Their dues fund the association's operations, and for tax purposes they are generally considered 501(c) (6) organizations. These associations often distribute marketing materials that include advertising by wineries and by retailers. Because the associations are funded by the winemakers, this is a violation of the Tied House prohibition against joint advertising with retailers.**
 - If a winery advertises its product and joins with a liquor retailer to indicate where that product can be obtained, that is a value to the retailer.
 - A retailer can advertise a brand of alcohol if the retailer initiates the advertising and doesn't receive payment from the supplier for doing so.
 - It's not what is advertised, it's who benefits. Suppliers want access to a retailers customers by advertising that their product is available at that location or inferring that it is.
 - The 2006 legislature adopted an exception that allows wineries to collectively produce tourism promotions that help tourists who want to come to a region to taste product find places to eat and sleep. That is all these trade groups can do. The wine commission is designed to market product and has a broader exception to tied-house to do so. These regional groups of wineries have not chosen to use this vehicle.

MONEY AND MONEY'S WORTH – Examples



- A special occasion license is granted to nonprofit organizations to hold events at which liquor is served. Industry associations are prohibited from obtaining special occasion licenses. This precludes the associations from hosting wine tastings that would allow them to educate consumers and give them a chance to “experience” the product, and would raise funds for the operation of the associations.
 - Industry Perspective: The statute provides for a special occasion license to be available to “nonprofit” organizations. It does not specify “charitable” organizations. A 501(c) (6) (“business league”) entity is a non-profit organization and should be allowed to hold a special occasion license.
 - State Perspective: Wineries can’t be retailers except in certain circumstances. A special occasion license is a retail license. Wineries who group together in an association are still wineries and using a special occasion license is holding both a manufacturing license and a retail license outside of the narrow exceptions allowed for wineries.

MONEY AND MONEY'S WORTH – Examples



- State Perspective (continued): Creating an exception allowing manufacturers to jointly advertise their products with specific retailers can lead to manufacturers being the necessary financing keeping some retail outlet in business. The influence of the manufacturer to get a retailer to sell product at reduced prices to get customers in the door can result in over-service and selling to whoever will come in and buy like young people under the age of 21.
- If wineries as manufacturers can jointly advertise their products with retailers to promote and sell their wine, why shouldn't Coors be able to jointly advertise their product with Mike's Tavern. Even if they shared the cost, how would the LCB know if the manufacturer was paying the entire cost to help Mike's get customers in the door or providing some other benefit to cover the joint cost of the advertising?

Discussion – Tied House Regulations



1. Do the current Tied House regulations support the policy goals related to beer and wine?
 2. Is there evidence that the Tied House regulations significantly impact industry businesses, consumers, society and/or the state? Are the impacts negative or positive?
 3. If there are negative impacts, are they significant enough to warrant a recommendation for change?
 4. Are there alternatives available that better meet the state's relevant policy goals and what are their impacts to industry businesses, consumers, society and/or the state? What, if any, recommendations should the Task Force put forth?
- ⇒ ***What is the state's continuing role in preventing domination among tiers and / or exclusion of product?***¹

Discussion – Tied House Regulation



1. Does the current Tied House regulations support the policy goals related to beer and wine?

Prevent the misuse of alcohol

.... Yes, strict adherence to the Tied House statutes, with narrowly drawn exceptions, continues to restrict the availability of alcohol, limits beer and wine advertising opportunities and constrains the impact of social norming that may contribute to increased abusive consumption.

Promote efficient collection of taxes

.... Does not contribute to or detract from the state's goal of efficient collection of taxes.

Foster the orderly and responsible distribution of malt beverages and wine towards effective control of consumption

.... Yes, the Tied House prohibition against overlapping ownership interests across the tiers contributes to keeping the supplier roles (manufacturer, importer, and distributor) separate and distinct from the role of the retail tier, and helps to keep suppliers from exerting undue influence on the retail tier to exclude competitor's products from the marketplace.

This assessment is based on feedback received from industry participants and a review of relevant documents and literature. It is not intended to provide an exhaustive evaluation.

Discussion – Tied House Regulation



- Is there evidence that the Tied House regulations significantly impact industry businesses, consumers, society and/or the state? Are the impacts negative or positive?

CONSUMER	Maintains higher prices because free market influences are diminished by the various prohibitions. According to many industry participants, these restrictions also serve to maintain product diversity by prohibiting practices designed to exclude competitor's products.
<i>(price, convenience, selection)</i>	
BUSINESS	Restricts free market influences by prohibiting some firms from entering into financial and ownership arrangements that may otherwise have positive economic results for the firm (and in some cases, such as public stadiums, some would argue positive economic results for the community.) Reduces industry participants' ability to conduct marketing and advertising that in other industries may be acceptable.
<i>(costs, unnecessary market restrictions, revenues, private employment)</i>	

This impact assessment is based on feedback received from industry participants and a review of relevant documents and literature. It is not intended to provide an exhaustive assessment of all potential impacts. The impacts identified have not been thoroughly tested or evaluated.

OTHER DATA?

Discussion – Tied House Regulations



2. Is there evidence that the Tied House regulations significantly impact industry businesses, consumers, society and/or the state? Are the impacts negative or positive?

STATE	<p>A small number of state employees are devoted to monitoring and enforcing trade practices that could otherwise be assigned to monitoring and enforcing outcome-based activities (e.g., overserving and serving underage drinkers). Some sales tax revenues might be lost because sales are lower with the money's worth provisions in place, but this is likely off-set by the fewer state resources devoted to enforcing and treating abusive consumption.</p>
<p><i>(state resources, state sales and tax revenues, state employment)</i></p>	
SOCIETY	<p>Limiting marketing and advertising practices reduces the potential for overserving, and underage drinking. Prohibiting overlapping financial interests and ownership, and limiting opportunities for providing inducements to purchase a manufacturer's product help prevent the type of domination and coercion seen pre-prohibition.</p>
<p><i>(alcohol misuse, youth access to alcohol, environmental pressures encouraging misuse)</i></p>	

OTHER DATA?

This impact assessment is based on feedback received from industry participants and a review of relevant documents and literature. It is not intended to provide an exhaustive assessment of all potential impacts. The impacts identified have not been thoroughly tested or evaluated.

Discussion – Tied House Regulations



3. If there are negative impacts, are they significant enough to warrant a recommendation for change?

Discussion – Tied House Regulations



Are there alternatives available that better meet the state's relevant policy goals and what are their impacts to industry businesses, consumers, society and/or the state? **What**, if any, recommendations should the Task Force put forth?

Straw Options (to spark discussion!)

1: No Change. Reaffirm the core principles of the Tied House statutes and limit or eliminate any opportunity for expansion of exemptions.

2: Relax current Tied House regulation and focus on regulating outcomes (such as monopolies, predatory sales practices or abusive consumption.)

Discussion – Tied House Regulations



⇒ *What is the state's continuing role in preventing domination among tiers and / or exclusion of product?*

Wrap Up and Next Steps



- **Two more meeting times are currently scheduled:**
 - 10/12 Meeting: Discussion Summaries / Recommendations
 - 11/17 Meeting: Final Report [NOTE DATE CHANGE]
 - 11/28 Meeting: Possible Meeting if needed to finalize report

Wrap Up and Next Steps



- **Next meeting's purpose and "homework" assignments**
 - Date/Time: Thursday October 12, 10a – 3p.

**** **LOCATION TBD** ****

- Purpose: to finalize Task Force recommendations, if any
 - Homework:
 - Review information you receive, including summary of today's meeting and next meeting materials.
 - Send general questions or comments to Sterling Associates by Friday 10/6 if it needs to be included for 10/12 meeting. (Public too.)
- **Questions?**

Adjourn



- Thank you!
- See you in two weeks - October 12...



Appendix - Info



- **Written comments from stakeholders and/or Task Force meeting audience are welcome (contact information must be included) and can be submitted via:**
 - LCB web site: WWW.LIQ.WA.GOV (link to Task Force)
 - Email to Sterling Associates (please address to both)
 - Jill Satran – jills@sterling-llp.com
 - Kim Rau – kimr@sterling-llp.com
- **Written comments received by Fridays before a Task Force meeting will be included in a consolidated document to the Task Force members. Written comments will be summarized and presented at each Task Force meeting. (They will not necessarily be individually addressed via email or by the Task Force.)**
 - Written comments submitted to the Task Force will be also be available for public viewing on the LCB's web site.

Task Force Ground Rules (doc #2)



- 1. Consistent attendance of members is critical to success.**
- 2. Preparation prior to each meeting is important.**
- 3. Conformance to due dates will keep the process on schedule and ensure adequate input.**
- 4. Meetings must be productive and move the process forward.**
- 5. All constructive viewpoints and ideas will be considered within the boundaries and scope of the study.**
- 6. The standard for decisions will be the majority opinion, with minority or dissenting comments.**
- 7. The final Task Force report will be written in the voice of the Task Force to the Liquor Control Board.**
- 8. Only Task Force members will participate in Task Force discussions. (Public written comments welcome – see next page)**

Task Force Charge



Chapter 302, Laws of 2006 (2SSB 6823)

NEW SECTION. **Sec. 13.** The liquor control board shall convene a task force to conduct a comprehensive review of the current regulatory system controlling the sale and distribution of beer and wine in Washington state. The board shall include stakeholders representing the producers, distributors, consumers, retailers, carriers, and legislators in conducting its review.

The task force shall review the genesis of the current regulatory system and whether the system in its current configuration should continue.

It shall identify key issues, concerns, and desired changes by stakeholders about the current system and shall identify alternatives or modifications to the current system.

The task force shall also research and analyze the impacts and implications of this act, and other suggested modifications to the system on distributors, producers, retailers, and consumers.

The task force shall make recommendations about any proposed changes to the system by December 15, 2006.